

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
GREAT BAY DELICATESSEN, INC. :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period September 1, 1982 :  
through July 15, 1985. :

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In the Matter of the Petition :  
of :  
ESTATE OF HOWARD B. LOCKMULLER :  
OFFICER OF GREAT BAY DELICATESSEN, INC. :  
: DETERMINATION  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period September 1, 1982 :  
through July 15, 1985. :

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In the Matter of the Petition :  
of :  
GREAT SOUTH BAY DELICATESSEN, INC. :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period September 1, 1982 :  
through July 15, 1985. :

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Petitioners, Great Bay Delicatessen, Inc., Estate of Howard B. Lockmuller, as officer, and Great South Bay Delicatessen, Inc., 539 Main Street, Bayshore, New York 11706, filed petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1982 through July 15, 1985 (File Nos. 802649, 802650 and 802820).

A consolidated hearing was commenced before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 12, 1988 at 2:30 P.M., and was continued to conclusion before the same Administrative Law Judge at the same location on February 28, 1989 at 1:45 P.M., with all briefs to besubmitted by May 30, 1989. Petitioners Great Bay Delicatessen, Inc. and Estate of Howard B. Lockmuller appeared on the first hearing date by Costa & Bernstein (William J.

Bernstein, Esq., of counsel), but did not appear on the continued hearing date. Petitioner Great South Bay Delicatessen, Inc. appeared on both hearing dates by Robert E. Dunn, Esq. The Division of Taxation appeared at the first hearing date by William F. Collins, Esq. (Gary Palmer, Esq., of counsel) and at the continued hearing date by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

### ISSUES

I. Whether the Division of Taxation properly determined upon audit that petitioner Great Bay Delicatessen, Inc. owed additional sales taxes.

II. Whether Howard B. Lockmuller (Deceased) was responsible for the payment of such taxes pursuant to Tax Law §§ 1131(1) and 1133(a).

III. Whether petitioner Great South Bay Delicatessen, Inc., the purchaser in a bulk sales transaction, is liable for sales taxes due from the seller in accordance with Tax Law § 1141(c).

IV. Whether the Division of Taxation timely notified petitioner Great South Bay Delicatessen, Inc. of its obligations as required by Tax Law § 1141(c).

### FINDINGS OF FACT

On October 2, 1985, the Division of Taxation issued two notices of determination and demands for payment of sales and use taxes due to petitioner Great Bay Delicatessen, Inc. ("Great Bay"), spanning, together, the period September 1, 1982 through July 15, 1985 and assessing a sales tax liability in the aggregate amount of \$29,296.93, plus penalty (Tax Law § 1145 [former (a)(1)]) and interest. On the same date, the Division of Taxation issued two additional notices of determination and demands for payment of sales and use taxes due spanning the same period and assessing the same amounts as above, against petitioner Howard B. Lockmuller (Deceased) as a person required to collect and remit taxes on behalf of Great Bay. In addition, the Division of Taxation issued on the same date two notices of determination and demands for payment of sales and use taxes due for the same period and assessing the same amounts as above, against petitioner Great South Bay Delicatessen, Inc. ("Great South Bay") as a purchaser in a bulk sale from Great Bay. These six notices were all based upon the results of a field audit of the business operations of Great Bay as described hereinafter.

On May 9, 1985, the Division of Taxation received a Notification of Sale, Transfer or Assignment in Bulk dated May 3, 1985. The notification indicated that a bulk sale of the business operated at 539 East Main Street, Bayshore, New York was to occur between Great Bay, as seller, and Great South Bay, as purchaser, on "approximately July 15, 1985". The notification further indicated that the scheduled date of sale was to be "within 72 hours of issuance of off premises beer license." Subsequently, on July 17, 1985, the Division of Taxation received a letter from petitioner's representative indicating that the sale of the business occurred on July 12, 1985.

On May 10, 1985, the Division of Taxation notified Great South Bay of a possible claim for New York State and local sales and use taxes due from the seller.

On May 24, 1985, the Division of Taxation notified Great Bay, the seller, that it would be contacted to make arrangements for an examination of its books and records. Thereafter, on July 31, 1985, an audit appointment letter was mailed to Great Bay requesting that it contact the

Division of Taxation to arrange an appointment date. This appointment letter specified the audit period to be September 1, 1982 through May 31, 1985, and indicated that all records pertaining to Great Bay's sales tax liability should be available for review including, but not limited to, journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and any other sales tax records.

On August 22, 1985, the auditor made a visit to the business premises. The premises consisted of a delicatessen selling prepared food, such as salads and sandwiches, and unprepared foods or groceries. At the time of the audit, the business premises were open 7 days a week, 6:00 A.M. to 9:00 P.M. Great South Bay had purchased the business from Great Bay on July 12, 1985. Prior to the purchase, the premises were also used for the operation of a delicatessen.

The Division of Taxation was advised by Mr. Lockmuller, in a letter dated June 10, 1985 and written on an invoice with the name, address and telephone number of Great Bay, that the books and records of the business were maintained at the offices of Leventhal & Leventhal, Great Bay's accountants. On August 23, 1985, the auditor went to the accountants' office. The auditor was provided with sales tax returns, Federal and State income tax returns, a check disbursements journal and a cash receipts book containing bank deposits. The auditor was not provided with cash register tapes or other source documents which delineated the business's sales activities or the amount of tax collected on each sale. Furthermore, the auditor was not provided with any records which showed how the reported sales tax was determined for each audit period.

The auditor was informed by Great Bay's accountant that he employed an estimated taxable ratio in reporting the sales tax due on Great Bay's New York State and local sales and use tax returns for the period in issue. The taxable ratio, according to the accountant, was derived from Great Bay's "day book", which was used to record cash purchases and sales. During the audit period, the estimated taxable ratios employed were as follows:

<u>Period</u>	<u>Taxable Ratio</u> <u>(Taxable Sales/Gross Sales)</u>
11/30/82	.266
2/28/83	.266
5/31/83	.266

8/31/83	.266
11/30/83	.261
2/29/84	.246
5/31/84	.266
8/31/84	.266
11/30/85	.266
2/28/85	.260
5/31/85	.250
8/31/85	.266

The auditor made both an oral and written request for the day book on August 23, 1985, but it was not provided by either the accountant or Great Bay. Included in the written demand was a request for the purchase invoices for the months of February, May, August and November of either 1983 or 1984. These were not provided to the auditor until October 4, 1985.

Given the presentation of the limited records described above, the use of an estimated taxable ratio to report sales tax due and the lack of source documentation which would detail the sales activities and the amount of sales tax collected, the auditor concluded that Great Bay had inadequate books and records for purposes of conducting a detailed audit and therefore determined to resort to indirect audit methodologies. More specifically, the auditor conducted an observation of the premises on September 24, 1985 between the hours of 8:00 A.M. and 3:00 P.M.

During the course of the observation, the auditor totalled all taxable sales made. The auditor recorded \$486.24 in taxable sales of prepared foods during the period from 8:00 A.M. to 3:00 P.M. The auditor assumed that all sales made prior to his arrival were taxable, while all sales made after his departure were nontaxable. The auditor added to the taxable sales he had observed \$75.69, which was the amount of sales that had occurred prior to his arrival. Total taxable sales of \$561.93 were compared to gross sales for the day, less sales tax collected, to arrive at a percentage of prepared food sales to gross sales of 50.96%. This percentage was reduced by 1/7 by the auditor to take into account reduced prepared food sales on Saturday and Sunday. Accordingly, the auditor determined that 43.68% of gross sales were taxable prepared food sales. Due to the failure of Great Bay to produce the purchase invoices requested (see Finding of Fact "7") prior to the time limitation of section 1141(c) of the Tax Law, the auditor was unable to determine a taxable ratio for unprepared food sales. Instead, based upon his review of the business premises, the books and records provided and the observation test, the auditor estimated a total taxable ratio of 65% for the audit period.

In reviewing the records of petitioner for the audit period, the auditor discovered that gross sales reported on the sales tax returns were less than gross sales reported on the Federal income tax returns. The auditor computed a margin of error of 1.1037095 and applied it to gross sales as reported on the sales tax returns in the audit period to arrive at audited gross sales. This amount was multiplied by the taxable ratio of 65% to arrive at audited taxable sales. The auditor compared this total to the total taxable sales reported per Great Bay's sales tax returns and arrived at a \$401,376.84 increase over taxable sales reported, with additional tax due computed thereon in the amount of \$29,296.93. In turn, the notices of determination described in Finding of Fact "1" were issued to petitioners. The auditor recommended that penalty be assessed based primarily on the lack of records and the comparison of reported taxable sales by Great Bay (\$19,272.00 per quarter) versus taxable sales determined upon audit (\$52,720.00 per quarter).

Following the issuance of the notices of determination, the auditor was provided with the purchase invoices previously requested of Great Bay (see Finding of Fact "7"). The auditor analyzed the purchase invoices and determined a taxable ratio for unprepared foods of 27.64%

and applied it to total purchases for the period September 1, 1982 through February 28, 1985 to arrive at total taxable purchases for that period. The auditor then applied a markup percentage of 40% to determine audited taxable sales of unprepared foods for such period.

To determine the markup percentage, the auditor reviewed an analysis performed by the Division of Taxation (Suffolk County District Office) of markups used by numerous delicatessens in Suffolk County. The analysis consisted of 33 delicatessens with an average grocery markup of 51.03%. The grocery markups ranged from a low of 34.55% to a high of 77.71%. Based upon a review of Great Bay's books and records, its business operation and his own experience, the auditor determined that a 40% markup was appropriate.

The audited taxable sales for both prepared and unprepared foods were totalled to arrive at total taxable sales. The auditor compared this total to the taxable sales reported by Great Bay for the period September 1, 1982 through February 28, 1985, and arrived at a \$373,074.06 increase over taxable sales reported. The amount of purchases for the periods ended May 31, 1985 and July 15, 1985 were provided to the auditor by letter from Mr. Lockmuller. The auditor chose not to use these purchase amounts because they were substantially less than previous quarters while sales during the quarter ended May 31, 1985 had increased over the prior quarters. Instead, the auditor multiplied the total sales reported for the two periods by a ratio using the earlier quarters of additional taxable sales to total reported taxable sales to arrive at additional taxable sales for the last two periods of \$48,306.69. This figure was added to the additional taxable sales for the earlier quarters to arrive at additional taxable sales for the audit period of \$421,380.75. The taxable ratio using this audit methodology was 67%. Although the additional taxable sales and taxable ratio were larger than those used in issuing the original notices of determination, the auditor did not re-issue the notices of determination to petitioners because allowances for personal use, pilferage and breakage had not been originally considered. The auditor reasoned that if these items were allowed in the audit methodology resulting in the higher taxable sales, the additional tax due would be approximately the same as the amounts on the notices of determination as issued.

At the initial hearing held on May 12, 1988, petitioners Great Bay and the Estate of Howard B. Lockmuller appeared by William J. Bernstein, Esq., pursuant to a power of attorney executed by Mrs. Florence Lockmuller as the president of Great Bay and the personal representative of the Estate of Howard B. Lockmuller.<sup>1</sup> At the hearing, Mr. Bernstein and Mrs. Lockmuller indicated that there had been no probate proceedings in the matter of Mr. Lockmuller and that there would be none in the future. Following the initial hearing date and prior to the second hearing date, two letters were received by the Division of Tax Appeals from Mrs. Lockmuller and Mr. Bernstein. Mrs. Lockmuller indicated that neither Mr. Bernstein nor herself would be appearing at the continued hearing scheduled for February 28, 1989, while Mr. Bernstein indicated that he had been relieved in the Great Bay matter and would not be at the hearing. Neither appeared at the continued hearing.

#### SUMMARY OF PETITIONERS' POSITION

Petitioners Great Bay and Howard B. Lockmuller assert that the auditor made the following errors:

- (a) That the observation test was conducted for only a portion of the business's daily

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<sup>1</sup>Mr. Bernstein indicated at the hearing that Mr. Lockmuller's responsibility was not at issue, but only the amount of tax due would be contested.

operations.

(b) That no allowance was made for pilferage, breakage or personal use in the initial audit performed.

(c) That the auditor used only the purchase invoices for four months rather than the entire audit period.

(d) That the auditor did not use actual sales prices in determining the mark-up percentage.

Petitioner Great South Bay as purchaser, asserts that it is not liable for the taxes determined to be due from Great Bay, as seller, in the bulk sale transaction because the Division of Taxation did not comply with the requirements of section 1141(c) of the Tax Law. Petitioner Great South Bay asserts that as the Notification of Sale, Transfer or Assignment in Bulk was received on May 9, 1985, and the notices of determination were issued on October 2, 1985, the Division of Taxation failed to notify it of any taxes claimed to be due from the seller within 90 days from receipt of the notice of sale. In the alternative, petitioner Great South Bay asserts that even if the date of receipt is deemed to be 10 days prior to the transfer date (see 20 NYCRR 537.2[c][6]), the notices of determination would still be untimely as it was issued more than 90 days after July 2, 1985, 10 days prior to the transfer date of July 12, 1985.

Petitioner Great South Bay takes issue with regulation 20 NYCRR 537.2(c)(6), as promulgated by the former State Tax Commission, which provides that a notice of sale received more than 10 days prior to the date

of transfer or sale of the business assets "shall be deemed to have been received not more than 10 days prior to the date of taking possession of, or payment for, the business assets whichever come first, regardless of the date when the notice is actually received". Petitioner claims that there is no statutory basis for this rule and that it is inconsistent with Tax Law § 1141(c), which provides only that the notice of claimed taxes due from the seller must be mailed within 90 days of receipt of the notice of sale.

### CONCLUSIONS OF LAW

A. A personal representative is a person who has received letters to administer the estate of a decedent (EPTL 1-2.13). At the hearing, Mrs. Lockmuller and Mr. Bernstein indicated that there had been no probate proceedings in the matter of Mr. Lockmuller and that there would be none in the future, and no letters to administer were introduced into evidence. Since an individual is not in a position to authorize another to act for her in a particular status before she has attained that status, the power of attorney granted to Mr. Bernstein from Mrs. Lockmuller relating to the Estate of Howard B. Lockmuller is void (see Corcoran v. Scolaro, 46 NYS2d 278 [1943], revd on other grounds, 267 App Div 871, 46 NYS2d 377; 2 NY Jur 2d, Agency, § 10). Therefore, as no representative appeared, the Estate of Howard B. Lockmuller is held to be in default. In light of this determination, Issue II is moot.

B. Tax Law §§ 1135 and 1142.5 provide that a taxpayer is under a duty to maintain complete, adequate and accurate records of its sales and to make the same available for audit upon request. Tax Law § 1138(a)(1) further provides that where adequate records are not maintained or made available, the Division of Taxation is entitled to resort to indirect methodologies, including external indices, in conducting audits and determining the accuracy of taxpayer's returns as filed.

C. Petitioner Great Bay does not challenge the Division's right to resort to an indirect audit method in this case. It is undisputed that petitioner's sales records were inadequate, given the lack of cash register tapes, guest checks or the "day book" which formed the basis of the filed sales tax returns, and thus the use of an indirect audit method was appropriate (Matter of Licata v. Chu, 64 NY2d 873; Matter of Vebol Edibles, Inc., d/b/a Hickory House, Tax Appeals Tribunal, January 12, 1989). The Division is not required to rely upon a taxpayer's non-source documentation and determine the amount of tax due based upon general ledgers or other secondary documents which cannot be verified (Matter of Meyer v. State Tax Commn., 61 AD2d 223, lv denied 44 NY2d 645; Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989). Thus, the only remaining issue with regard to the audit is whether the particular methods employed, or the results thereof, were irrational or erroneous.

D. Petitioner Great Bay has presented no evidence to refute the audit methodology employed, or to support any reduction or abatement of the amount of tax or penalty determined to be due for the period under audit. Petitioner has the burden to establish by clear and convincing evidence that the audit method was erroneous (Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858). Petitioner has failed to satisfy this burden in its general attack on the audit. Where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to indirect audit techniques, exactness is not required of the Division of Taxation in arriving at its determination, and the consequences of recordkeeping failures in this regard weigh heavily against the taxpayer (Matter of Meskouris Brothers, Inc. v. Chu, 139 AD2d 813).

Accordingly, the audit procedures described herein and the results thereof are sustained for the period under audit (see, Matter of Meskouris Brothers v. Chu, *supra*; Matter of Gaetano Vendra d/b/a Pete's Pizzeria, Tax Appeals Tribunal, February 9, 1989; Matter of Vebol Edibles, Inc. d/b/a Hickory House, *supra*).

E. Tax Law § 1141(c) provides, in summary, that whenever a person required to collect tax shall make a sale, transfer or assignment of his business assets other than in the ordinary course of business, a notification of sale, transfer, or assignment in bulk must be filed with the Division of Taxation by the purchaser at least ten days prior to such sale, transfer or assignment. Thereafter, the Division of Taxation has a period of 90 days from said notification within which to determine the existence of any outstanding sales and use tax liabilities and to assess the same.

F. Tax Law § 1141(c) further provides that for failure to comply with the aforementioned provisions the purchaser in a bulk sale may be held liable for any sales or use taxes determined to be due from the seller limited in amount, however, to the greater of either the purchase price or fair market value of the business assets sold, transferred or assigned.

G. The purpose of section 1141(c) is threefold: (1) to provide the Division of Taxation with adequate time to determine whether there are any taxes due the State from the seller of a business prior to the consummation of the sale; (2) to provide the Division of Taxation the opportunity to determine the extent of the seller's tax liability to the date of the sale; and (3) to preserve the Division's ability to collect any of the seller's liability from the consideration for the assets of the business being transferred. The purpose is accomplished by requiring the purchaser to notify the Division of the proposed sale and by requiring the Division to notify the purchaser and the seller in order to secure its first priority right and lien against the consideration for the business (see, Matter of Giovanni Velez, Tax Appeals Tribunal, May 26, 1988).

H. 20 NYCRR 537.2(c)(6) provides:

"Every timely notice received more than 10 days prior to the date of, or payment

for, the business assets shall be deemed to have been received not more than 10 days prior to the date of taking possession of, or payment for, the business assets, whichever comes first, regardless of the date when the notice is actually received."

This section became effective on December 27, 1982 and was promulgated by the former State Tax Commission pursuant to Tax Law § 171(1) which provides that "the State Tax Commission shall make such reasonable rules and regulations, not inconsistent with the law, as may be necessary for the exercise of its powers and the performance of its duties".

I. This section of the regulation is consistent with the purpose of Tax Law § 1141(c). It provides the Division of Taxation with the opportunity to both determine the seller's tax liability to the date of sale and preserves the Division's ability to collect such liability from the proceeds of the sale. Petitioner's argument that the Division of Taxation must notify the purchaser of its claim against the seller within 90 days of the filing of the notice of sale, regardless of the filing date of the notice and the date of sale, is flawed. Carried to its logical conclusion, this argument means that the Division of Taxation would lack sufficient time to audit the seller's books and records to the date of sale and issue the notices of determination to the purchasers in order to collect the seller's sales tax liability from the proceeds of the sale. A notice of sale filed more than 90 days prior to the date of transfer would preclude the Division of Taxation from collecting any seller's tax liability that arose between the running of the 90-day period following the filing of the notice of sale and the date of transfer. This result is inconsistent with the principles underlying the purposes of Tax Law § 1141(c). Accordingly, it is held that 20 NYCRR 537.2(c)(6) is consistent with Tax Law § 1141(c) and reasonable and necessary to carry out its purpose.

J. In this matter, pursuant to 20 NYCRR 537.2(c)(6), the notice of sale is deemed to have been filed on July 5, 1985 or 10 days prior to the transfer date listed on such notice. The notices of determination were issued to Great South Bay on October 2, 1985, 89 days after the deemed filing of the notice of sale. Thus, the notices of determination were timely issued.

K. Petitioner Great South Bay cannot rely upon 20 NYCRR 537.2(c)(6) with regard to its subsequent notification to the Division of Taxation, dated July 12, 1985, that the sale of the business occurred on July 12, 1985. Such section of the regulations applies where the notice of sale is received more than ten days prior to the date of transfer. The July 12, 1985 letter was received after the transfer date, on July 17, 1985, and not more than ten days before the transfer date. Therefore, 20 NYCRR 537.2(c)(6) is inapplicable to the letter received by the Division of Taxation on July 17, 1985 advising that the date of transfer was July 12, 1985. In the alternative, using the July 17, 1985 as the date of receipt of the notice of sale, the notice of determination issued on October 2, 1985 was unquestionably timely (see, Zorba Endicott Restaurant Corporation, Inc. v. Chu, 126 AD2d 820).

L. The petitions of Great Bay Delicatessen, Inc., Estate of Howard B. Lockmuller and Great South Bay Delicatessen, Inc. are denied, and the notices of determination and demands for payment of sales and use taxes due dated October 2, 1985, together with such penalty and interest as is lawfully due and owing, are sustained.

DATED: Troy, New York  
October 12, 1989

/s/ Dennis M. Galliher  
ADMINISTRATIVE LAW JUDGE